FOX SHORT SALE NEGOTIATORS

Income Tax After A Short Sale

After a short sale, there is still one more type of paperwork that the seller has to accomplish and it pertains to income tax after a short sale. Ordinarily, a debt that has been forgiven is still treated as taxable income. However, because of the Mortgage Forgiveness Debt Relief Act of 2007, homeowners may qualify to exclude the forgiven debt from the net taxable income but what is considered as a forgiven debt and what makes a homeowner qualified for debt relief? It is important for a homeowner who just went through a short sale to fully understand the provisions under Mortgage Forgiveness Debt Relief Act of 2007 since not all types of debt forgiven can be excluded from the net taxable income. By doing so, a homeowner can avoid paying for unnecessary taxes or being penalized for excluding a taxable income. Here are the common questions that relate to income tax after a short sale.

Question:
What is forgiven debt?

Answer:
A forgiven debt is an amount you owe your lender but have been waived usually as a result of a request backed by a very valid reason. In the case of a short sale, a forgiven debt is the difference between the selling price and the mortgage which the lender or bank has waived because of your valid hardship situation.

Question:
What is exclusion of forgiven debt or income?

Answer:
Ordinarily, debt that has been waived by a lender is considered taxable since it constitutes as an income. If however, a forgiven debt like a waved debt in short sale qualifies for debt relief under the Mortgage Forgiveness Debt Relief Act of 2007, it is 'excluded' or not reported on the list of income when filing for the annual **income tax after a short sale**.

Question:
Does the Mortgage Forgiveness Debt Relief Act of 2007 cover all types of forgiven debt?

Answer:
Not all types of forgiven debt relating to a mortgage qualify for debt relief and not all of the amount of the forgiven debt can be excluded as well. Under the act, only debt used to 'acquire, construct and improve the principal residence'. The debt is properly termed as qualified principal residence indebtness. This also includes debts used to refinance debt used for the said purposes but should be secured by the principal/primary residence of the homeowner.
A homeowner can exclude forgiven debt up to $ 2 million.

Question:
Does the Mortgage Forgiveness Debt Relief Act of 2007 cover rental homes?

Answer:
The act covers for principal homes only; thus, forgiven debt relating to a short sale of rental or vacation homes do not qualify for exclusion. As a homeowner may live in different homes throughout the year, only the home where he or she spends time most is considered a principal

home. In preparing income tax after a short sale, the homeowner must submit proof that the said property was his/her principal residence.
The principal residence must also be occupied by the homeowner until the short sale was completed. So if a homeowner had moved out of the home when a foreclosure was seen to happen. But then before the foreclosure was enforced he managed to get approved for a short sale, the forgiven debt would not qualify as an exclusion from income tax after a short sale.

Question:
How do homeowners know the exact amount of forgiven debt?

Answer:
The amount of the forgiven debt will come from the lender or bank and will be written on a Form 1099-C Cancellation of Debt. This form includes the creditor's name and identification number, debtor's name, amount of debt cancelled interest if included in the debt cancelled; fair market value of said property, and the date the debt was cancelled. If a homeowner does not receive the form by February 2, it should be followed up with the lender in order to appropriately file exclusion from income tax after a short sale. Homeowners should also verify the amount on the form and if any discrepancy is seen, he or she should contact the lender. The amount of short sale deficiency should be at least $600 or more; otherwise, it does not qualify as indebtedness income.

Question:
How does a homeowner report the exclusion from income?

Answer:
After receiving the Form 1099-C Cancellation of Debt from the lender, the homeowner should report the same amount on Form 982-Reduction of Tax attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment). The homeowner should check the appropriate box on Part 1 –General Information where circumstances leading to the exclusion are itemized. In the case of a short sale, qualified principal residence indebtedness should be ticked. Additionally, the same amount that appears on the 1099-C Form should be reported on box 2 of Form 982.

Question:
Are there any other circumstances a homeowner can claim exclusion if the forgiven debt does not qualify under qualified principal residence indebtedness?

Answer:
Under Form 982-Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment), exclusion from the forgiven or cancelled debt may include those resulting from a bankruptcy, non-recourse loans, insolvency and farm debts.

If you are a homeowner who is in the process of a short sale in order to avoid a foreclosure, the IRS encourages seeking professional advice especially on whether you will qualify for exclusion of a certain amount on your income tax after a short sale. This should avoid paying for non-due taxes or getting penalized for not paying taxes on a wrongly assumed exclusion.

To better assist you in any questions you may have, please, contact Fox Short Sale Negotiators at: (630) 584-9330